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The Healthcare Company of the 21st Century

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The New Star: Health Care

Tech: What's Hot, What's Not

COVER STORIES

Health Care Stocks THE HIDDEN GROWTH STARS

Why do so many growth-fund managers know as much about pacemakers as computers? Because health care companies have been growing like crazy. Now you know.

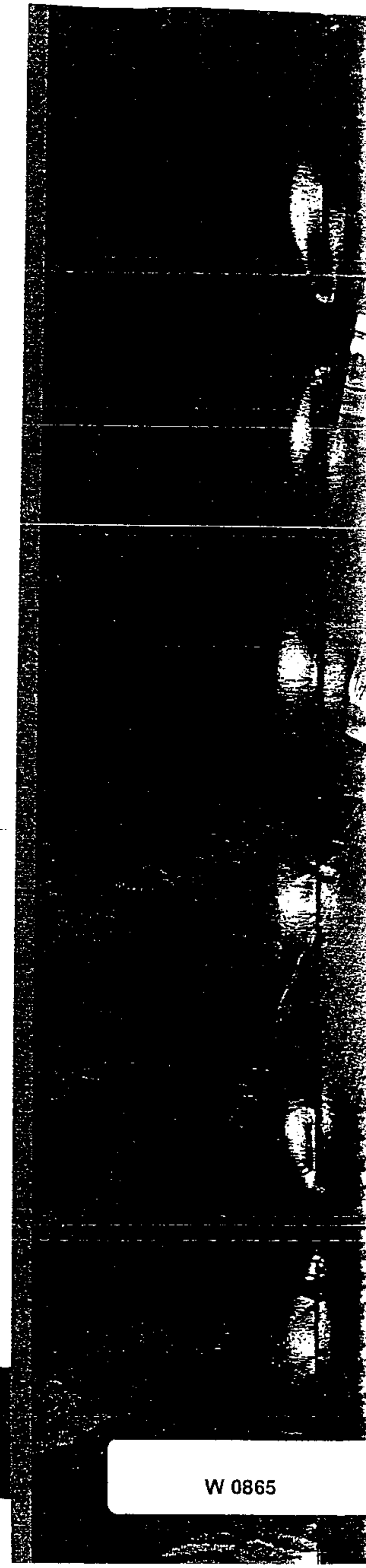
by Andrew E. Serwer

BILL SULLIVAN, PRESIDENT OF OXFORD HEALTH PLANS, IS IN TROUBLE. HE'S ABOUT to make his company's case to some 200 analysts and money managers who own hundreds of millions of dollars of Oxford stock, and suddenly his laptop zonks out. The slides for his presentation are gone.

ANN STATES—SABA

So Sullivan takes a deep breath and launches into a 30-minute ad lib on Oxford, an HMO with over $2 billion in annual sales. It's a nice recovery, but one that is made a whole lot easier by the fact that Oxford's revenues are growing over 125% annually—making it America's fifth-fastest-growing company—its earnings are compounding north of 75%, and its stock has climbed from about $4 a share to $47 in less than four years. A ten-bagger, as folks in his audience would say.

Oxford Health Plans? The fifth-fastest-growing company in America? Well, yes, actually. And this is no anomaly. Despite all the talk about the need to control health care costs—indeed, in no small part because of such concerns—the health care industry has simply exploded. Companies that have figured out how to take advantage of the changing nature of the business—companies like Oxford and Phycor and Healthsouth, all of which made it onto FORTUNE's fastest-growers list—have outperformed, over the past three years, even such high-profile tech stocks as Microsoft, Cisco Systems, and America Online. Though this may come as a surprise to most investors, it isn't to those who manage



Richard Scrushy, a sometime country musician, has a hit on his hands with Healthsouth.

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money for a living. Just ask any of the more than 130 fund managers who have a stake in Oxford.

What's more, while tech gets all the glory, health care stocks in some ways make more sense for most investors. People understand health care in a way they'll never understand, say, how the latest gallium arsenide semiconductor works. "I wonder how many investors can really explain what Cisco does," says Dan Miller, a growth-fund manager who runs over $30 billion in assets for Putnam Investments in Boston. Miller is a big fan of health care stocks. "Health care stories are all around us," he adds. It's the Peter Lynch theory writ large: Sometimes the best investments are the ones that emerge from everyday life.

"Coke is what, 100 years old?" says Scrushy as he contemplates Healthsouth's future. "I think we'll get to where Coke is quicker than they did."

Here's another surprise: Health care isn't just a big business; it's the *biggest* business. Over $1 trillion was spent on health care in the U.S. last year, or 14% of GDP, the largest single slice of nongovernment spending. And medical expenditures are expected to climb about 8% annually for the balance of the decade. A time to buy, then? Yes, but carefully—as is usually the case with growth investing.

The health care companies on FORTUNE's list—they number 12 and make up the second-largest group after technology—generally fall into two categories. One is the familiar medical-device companies, for which new technologies create new growth opportunities. The other is something new: health care providers that are national in scope. These are companies that are taking advantage of the wholesale move toward managed care by gathering big populations of more or less captive customers and offering economies of scale that please insurance companies.

These latter companies are growing largely through acquisition. Ben Lorello, mergers-and-acquisitions specialist at Smith Barney, estimates that there have been some 300 health care deals done over the past three years. "I've been a health care banker for 15 years, and this is the strongest period of consolidation I've ever seen," he says. For investors, this can make matters tricky. Growth through acquisition is a legitimate strategy, of course, but the game is less about knowing when to buy than when to sell. As growth-fund manager Garrett Van Wagoner points out, "An acquisition strategy eventually runs out of gas, simply because, as the company gets bigger, it has to make increasingly large acquisitions. And the bigger the company is, the harder that is to do."

One of the most aggressive acquirers—and one that shows no signs of running out of steam—is Healthsouth (No. 40), run by hard-charging Richard Scrushy (pronounced "scrooshy"). Scrushy has turned what used to be thought of as niche businesses—rehab clinics and outpatient surgery—into a big-time national chain. Based in Birmingham, Alabama, Healthsouth operates over 1,000 centers across the country; it has become the largest health care company in the country in terms of locations and the second largest (after Columbia/HCA) in terms of market capitalization, with close to $6 billion in shareholder equity. Ten years ago Healthsouth went public at a split-adjusted $2 a share. Today the stock sells for $36, making Scrushy's share worth around $360 million.

Healthsouth has etched out a particular reputation in the area of sports injuries. Scrushy is a huge sports fan and a friend of such pro athletes as Bo Jackson and Charles Barkley. More to the point, though, Healthsouth's best-known practitioner, Dr. Jim Andrews of Birmingham, is one of the tiny handful of orthopedic surgeons renowned for treating professional athletes. Scrushy also has an athletic advisory board that includes, among others, Jackson, Michael Jordan, and Troy Aikman—all of whom are patients of Andrews. Not surprisingly, hundreds of professional, college, and even high school sports teams have engaged Healthsouth to run their rehab programs.

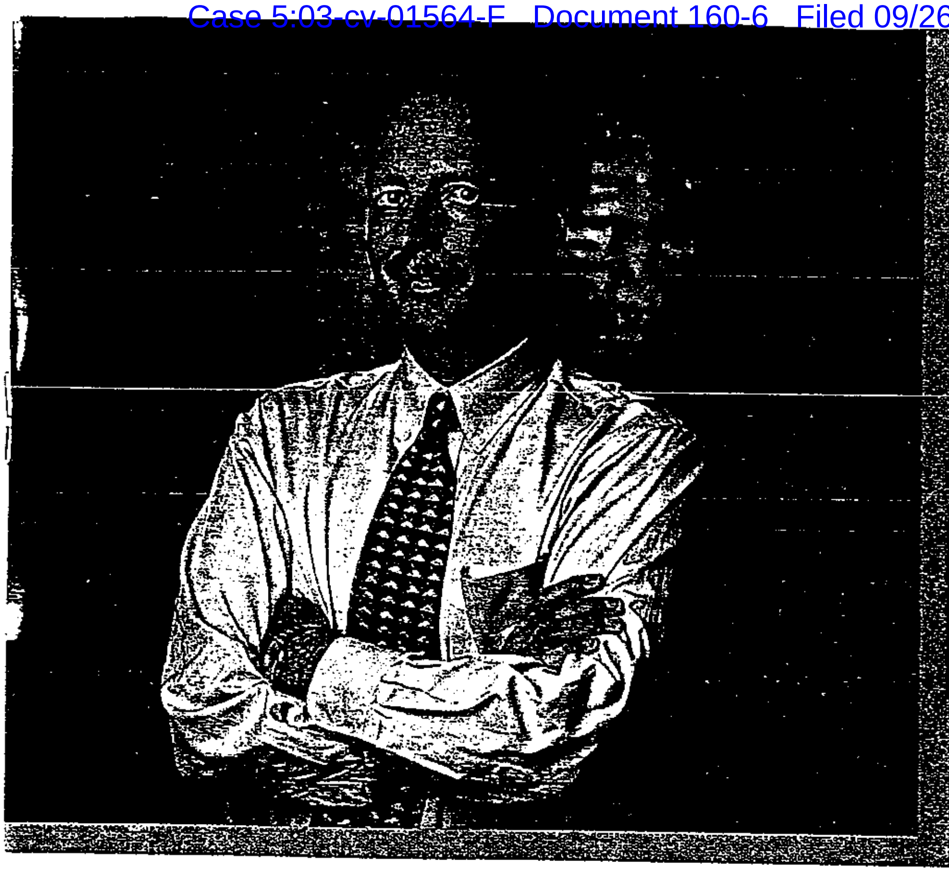
Sometimes even professional investors can be dazzled by Healthsouth's sports celebrities. During a visit to Healthsouth last February, Michael Carmen, then a portfolio manager with State Street Research in Boston, was given a tour of the hospital center, where he saw Aikman lying in the O.R., about to get arthroscopic surgery on his elbow. After observing the operation, Carmen, a huge football fan, ordered up some 500,000 shares of Healthsouth, then worth some $17 million.

Mostly, though, what impresses Wall Street about Healthsouth is its track record. "That is one very strong management team," says Putnam's Dan Miller, who owns over $125 million of Healthsouth stock. "They are adding value and lowering costs."

Scrushy, born in Selma, Alabama,

ED QUINN—SABA

"Health care stories are all around us," says Dan Miller, a growth-fund manager at Putnam.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"No, don't sell the stock," implored St. Jude's Stephen Wilson at an investor conference.

founded Healthsouth in 1984 when he was 32. Had his company flopped, he had a backup career option—as a country musician. Scrushy cut an album in Nashville and performed there with Marty Stuart. He still pals around with country stars like Alabama, Brooks and Dunn, and Faith Hill. At a Robertson Stephens conference a few years back, Scrushy got up and jammed with the house band at an evening party. "The guys weren't cookin' too good, and they needed my help," he explains.

"The man is a trip," says one analyst. "Wind him up and watch him go." Adds Miller: "He's kind of like a preacher." Indeed, his powerful persona has not been lost on Alabama's political establishment. A group of Alabama businessmen raised $5 million in pledges for Scrushy if he would run for governor. But he declined. "You know, my friend Charles Barkley may decide to run someday, and he may need my help," says Scrushy.

"I think investors expect us to provide them with growth," says Scrushy. "Coke is what, 100 years old? It has $20 billion in sales and a $130 billion market cap. We've been around for only ten years. Our brand name is just beginning to get known, and we have $2.5 billion in sales and over $5 billion in equity. I think we'll get to where Coke is quicker than they did."

"An acquisition strategy eventually runs out of gas," notes fund manager Garrett Van Wagoner. The trick for investors is to know when to sell.

Entrepreneurs like Scrushy with big, ambitious goals have to learn not just how to build their business but also how to build bridges to Wall Street, and Scrushy seems to have mastered the art. His main dealmaker is Smith Barney's Lorello, who is widely viewed as the premier health care investment banker—as he'll be the first to tell you. ("Right now we're the powerhouse in the business," says Lorello. "We have a 16% market share in health care investment banking." A typical industry leader will usually have between a 7% and a 10% share.) Over the past two years Lorello has helped Scrushy make nine acquisitions, worth $2.6 billion.

Scrushy is also close to Geoff Harris, 34, Smith Barney's head health care analyst, who, with Lorello, makes up the firm's health care tag team. Harris, in fact, is considered by many to be the health care industry's "ax," Wall Street parlance for the analyst who most moves stocks with his buy and sell recommendations. Healthsouth has been a Harris favorite since he started working at Smith Barney six years ago. "This company embodies nearly all the positive trends in this industry: consolidation, cost efficiency, good use of information systems. I have a near-term price target in the mid-40s for the stock," he says, which would represent about a 20% rise from its current price.

Of course, given the fact that Smith Barney does so many deals with Scrushy, perhaps it's not so surprising that its health care analyst is high on the stock. Some on Wall Street whisper that Harris allows Lorello's investment banking deals to influence some of his stock picks—which both Lorello and Harris stoutly deny. "I guess there is some jealousy of success out there," retorts Lorello. And without question, Harris's bullishness on Healthsouth has been dead-on.

Meanwhile, in the somewhat less contentious confines of Minneapolis—one of the hot zones of the health care business—acquisitions are at the heart of another medical company's growth strategy. But for St. Jude Medical (No. 43), the world's foremost manufacturer of heart valves, buying other companies is not so much about accelerating growth as rekindling it. While St. Jude's stock has been a great performer over the years, it's been in a holding pattern lately. "The company has been going through a challenging period," says Rick Wise, a respected Bear Stearns analyst. "They have been frustrated waiting for approval of new products, and earnings have been hit because of an acquisition." That means St. Jude's CFO, Stephen Wilson, had to do a little extra lobbying for his company at a recent Dain Bosworth conference.

"Oh, no, don't sell the stock," Wilson implores an institutional salesman outside the Oslo conference room in the Minneapolis Radisson Plaza Hotel. "Go look at the insider selling. They're not selling, so why should you?" (The salesman promises he won't.) Actually, St. Jude's problems would be the envy of many other companies. The company's core heart-valve business has a 48% market share, more than twice that of its nearest competitor. "St. Jude has a great franchise," says John Ballen, who manages the top-performing $5 billion MFS Emerging Growth Fund. "They make heart valves for $100 and sell 'em for $3,000. And it takes a decade for a competitor to come in." Ballen is exaggerating a bit on the margins—they make 'em for under

$1,000—but he sure is right about the high barriers for potential competitors. As Ben Williams of Moody Lynn puts it, "St. Jude's heart valves are the industry standard. The business is also protected by patents and FDA approval."

For years the heart valve business enabled St. Jude to grow at rate of more than 40% annually. But by the early 1990s, St. Jude and others began to saturate the market. "Today," says Wilson, "our heart valve division is growing about 8% annually."

Two years ago, in an effort to ratchet up the company's growth, St. Jude CEO Ron Matricaria switched to an acquisition strategy. First, St. Jude's bought Pacesetter, a company that makes—guess what?—pacemakers. Wall Street applauded the deal. "I don't think St. Jude knew how good a buy Pacesetter was," says Rachael Scherer, an analyst with Dain Bosworth. Then, earlier this year, it bought Daig, a maker of specialty cardiac catheters, for $400 million of stock. It was a dilutive acquisition, and this time Wall Street booed. St. Jude's stock has drifted down from a high of $45 a share this year to $31. Though the stock has recently bounced back to $39—three analysts recently rated the stock a buy—it's still relatively cheap for this group, with a P/E of 17 on 1997 earnings. Plainly, Wall Street investors are waiting to see whether St. Jude can pull off its shift in strategy.

A rule of thumb for growth investors: There's almost never "just" one bad quarter. A slip in earnings usually signals that something is seriously awry.

For growth investors, it is a mixed blessing when a large number of growth funds begin moving en masse into a particular stock. Many growth-fund managers operate under strict and unforgiving criteria, which revolve mainly around earnings momentum and the ability of a company to consistently beat Wall Street's estimates. When they see earnings momentum, they tend to climb aboard. (Also, there is a certain self-fulfilling prophecy at work here: As more and more funds buy a stock, their buying pushes up the price.) But they can also be fickle; while high P/E ratios don't necessarily faze them, the minute a company shows even the slightest earnings weakness, they shed it. And that selling, of course, can cause the stock to plummet.

Of the stocks on FORTUNE's list, the one that most clearly has been the beneficiary of such a buying spree is Nashville-based Phycor (No. 37), which is in the PPM, or physician practice management, business. This is a classic example of a modern health care company's taking advantage of the trends sweeping the country. Phycor is in the business of buying up doctors' practices all across America, running the business for the doctors, imposing management practices and efficiencies that cut costs—and then taking a cut of the business. Phycor has been growing like crazy: With sales of about $590 million, its growth rate is over 60% annually—and its market cap is approaching $2 billion.

Four years ago Phycor's stock sold for about $3 a share, and only seven mutual funds owned a total of 520,000 shares. Today the stock trades for $36, and 110 funds own 14 million shares. At 64 times earnings, it's not cheap, something its CFO, John Crawford, acknowledged to analysts at a recent Bear Stearns health care conference. "We are a high-multiple, high-growth stock," he says. "But our operating margins have climbed to 9%, and we think we can move them up to 11% or 12%."

Here's another rule of thumb for growth investors: There's almost never "just" one bad quarter. Generally a bad quarter will signal that something is seriously awry—and almost always be an augur of bad quarters to come. Healthsource (No. 12), an HMO based in Hooksett, New Hampshire, is a case in point. Reporting one strong quarter after another, Healthsource saw its stock rise in 3½ years from $5 to $40 per share. But then, early this year, it all went sour, and the stock dropped back to $10 by August. (It's recently bounced back above $15.) One fund manager looking at the company's stock chart whistles and says, "Whew, right off the g.d. cliff."

What happened? "We had really bad pricing this year," says CEO Dr. Norman Payson. "Then health care costs rose more than expected. At that point we were cruisin' for a bruisin'." The free fall bashed Healthsource shareholders, but no one took more of a bruisin' than Payson. He owns 5.6 million shares. And, he concedes, things aren't going to turn around immediately. "Earnings will be down this year," he admits. Although many fund managers are now shying away from the stock, Ballen, at least, is a buyer. "I own about 10% of the company [worth about $93 million]," he says. "I bought after it announced the bad news, so my downside risk is low, and if it works out I'm looking at 30% growth." Well, we'll see.

Actually, many of these health care stocks are off their highs right now. After a run-up earlier this year, bad news at many HMOs—which were hit by higher costs and weak pricing—spurred a selloff in health care stocks this summer, which paralleled the selling in tech stocks. "Usually tech stocks and health care don't move together because tech is much more cyclical," says Miller of Putnam. "Health care stocks were sold with tech stocks because people were dumping high P/E stocks."

But Harris of Smith Barney thinks all the long-term trends for the group are in place. Earnings are still rising at a rate of about 20% for the group. Still, "retail investors shouldn't own just one stock because we are talking about some new businesses here," Harris says.

On FORTUNE's fastest-growing-companies list, Harris recommends Oxford and, of course, Healthsouth. He also likes HBO & Co., which sells health care information systems software. Besides Healthsouth, Miller of Putnam also owns Phycor. Wise of Bear Stearns likes Boston Scientific, which dominates the catheter business.

And for investors who prefer the mutual fund route, there are a number of good growth funds that are run by health care-savvy managers like Ballen (MFS Growth) and Miller (Putnam's New Opportunities, Voyager, and OTC Emerging Growth). A third possibility is the Van Wagoner Emerging Growth fund, managed by Garrett Van Wagoner. For true believers, there are health care sector funds. One of the best is Vanguard's Specialty Healthcare Portfolio, run by Ed Owens. Owens's fund is up 14% so far this year and 27% annually over the past three years.

So the next time someone sidles up to you with drink in hand and starts yapping about the Internet, yawn and ask, "Yes, my friend, but have you heard about the hot new implantable defibrillator that just came on the market?" F

REPORTER ASSOCIATE *Melanie Warner*

FASTEST-GROWING COMPANIES

100 RANK (• Number of previous times on list)	COMPANY	REVENUES: ANNUAL GROWTH RATE	REVENUES: Past four quarters in millions / Rank	NET INCOME: Per share annual growth / Rank	NET INCOME: Past four qtrs. in millions / Rank	STOCK: Price 9/11/96 / Change from year earlier	STOCK: P/E past four qtrs.	STOCK: Market value in millions / Rank	WHAT THEY DO (▲ Technology ✚ Health care Energy ● Other)
21	ATC COMMUNICATIONS	75%	$94.3 / 86	173% / 9	$5.9 / 81	$18.06 / 434%	72	$263 / 62	● Customers like AT&T, Western Union, and Pac-Bell use this company to manage their customer service centers and to hire and train new employees.
22 •	UNITED WASTE SYSTEMS	72	$268.7 / 53	40% / 56	$30.0 / 39	$31.25 / 50%	25	$1,065 / 31	● Operates nonhazardous landfills, runs transfer and recycling services, and collects waste from corporate and private customers.
23	BARR LABORATORIES	72%	$232.3 / 58	–5% / 81	$6.5 / 79	$28.50 / 80%	62	$398 / 51	✚ Record sales of tamoxifen, a drug used to treat breast cancer, and other generic prescription products were a healthy combo for this pharmaceuticals outfit.
24	ALL AMERICAN COMMUNICATIONS	72	$241.2 / 55	— / —	$11.0 / 67	$9.25 / –33%	8	$54 / 90	● *Baywatch* syndication added bounce to this TV and music production company, as did the acquisition of Mark Goodson Productions and its game shows.
25	ALLIED WASTE INDUSTRIES	72%	$231.7 / 59	— / —	$13.1 / 62	$9.13 / 7%	51	$520 / 46	● Added $33 million to sales with the acquisition of three landfills, 15 garbage-collection companies, two recycling facilities, and three transfer stations.
26	ROTECH MEDICAL	71	$219.4 / 61	30% / 62	$18.7 / 54	$13.63 / 9%	17	$345 / 52	✚ This home health care company focuses on small towns and rural areas, providing doctors and nurses along with respiratory therapy and the like.
27	ATMEL	70%	$877.9 / 14	79% / 25	$164.5 / 4	$24.88 / –22%	15	$2,418 / 12	▲ Rapid growth in the use of cell phones and laptops translates as more business for this maker of the chips used in all kinds of portable gadgets.
28	INPUT/OUTPUT	70	$278.3 / 52	41% / 54	$38.7 / 29	$34.13 / 90%	37	$1,446 / 23	▲ From desert to tundra, its all-terrain seismic instruments are in high demand in the oil and gas industry, especially in the former Soviet Union.
29	PLAYERS INTERNATIONAL	70%	$305.4 / 49	81% / 22	$19.1 / 53	$6.63 / –61%	11	$193 / 69	● This operator of riverboat casinos in Illinois, Louisiana, and Nevada is betting on dry land, building a $286 million complex in Missouri.
30	LAM RESEARCH	68	$1,276.8 / 9	88% / 16	$141.1 / 7	$22.50 / –61%	5	$617 / 42	▲ Another beneficiary of the chip boom, LAM is big in the business that etches the circuit design on chips, enabling them to perform millions of tasks.
31	KUHLMAN	67%	$431.4 / 36	% / 72	$14.3 / 61	$16.63 / 33%	15	$220 / 66	▲ Get wired. Everyone else is—and using this company's wire and cable products to hook up faxes, phone lines, computers, and the like.
32 •	ALTERA	66	$487.8 / 33	99% / 15	$107.9 / 14	$42.38 / –36%	18	$1,851 / 18	▲ Telcos and PC manufacturers like Altera's "logic" chips, which can be programmed to help other devices accomplish tasks like routing telephone traffic.
33 •	UNITED STATES FILTER	66%	$531.8 / 31	— / —	$23.9 / 43	$27.00 / 85%	46	$1,303 / 27	● Expanded its product line of water-treatment equipment and services by buying companies with strong market positions and technologies.
34	KLA INSTRUMENTS	66	$694.9 / 18	132% / 12	$120.9 / 12	$18.88 / –58%	8	$955 / 35	▲ New construction of semiconductor fabrication facilities kept demand high for KLA's systems for detecting minuscule flaws in the manufacturing process.
35	3COM	63%	$2,327.1 / 2	74% / 29	$177.8 / 3	$48.88 / 12%	49	$8,166 / 1	▲ The access routers, switches, and adapters made by this company help connect network users and are much in demand.
36	LOMAK PETROLEUM	63	$72.9 / 93	41% / 54	$8.0 / 76	$13.00 / 49%	28	$185 / 71	Some 60 acquisitions not only increased assets, sales, and cash flow for this Texas oil and gas company but also gushed through to the bottom line.
37 •••	PHYCOR	61%	$588.7 / 26	25% / 69	$29.2 / 40	$31.50 / 52%	63	$1,705 / 22	✚ Doctors pay this company to group them into a regional association, provide their equipment and facilities, and negotiate their contracts with insurers.
38 ••••	STARBUCKS	61	$629.5 / 22	48% / 49	$34.9 / 33	$32.50 / 55%	71	$2,306 / 13	● A five-time member of the fastest-growing list, the coffee chain had 738 stores by the end of 1995 and just opened one in Tokyo.
39	AMERICAN HOMEPATIENT	61%	$212.2 / 64	38% / 57	$11.5 / 65	$22.50 / 17%	24	$313 / 57	✚ Sells or rents medical equipment, provides intravenous feeding, and lays on respiratory therapy—all in the patient's home. Bought 25 small competitors.
40 •••	HEALTHSOUTH	[illegible]	$1,996.1 / 6	29% / 64	$158.1 / 5	$35.13 / 49%	26	$5,435 / 3	✚ This operator of outpatient surgical services and comprehensive rehabs benefits from ongoing demand by employers and insurers for lower costs.

The Sports Medicine Network

HEALTHSOUTH®

This year, countless numbers of competitive and recreational athletes will sustain some type of sports-related injury. As a result of advances in patient care, technology and research, more of these individuals, who might have at one time been forced to discontinue their active life, will now have the opportunity to return to their individual sport or activities. Which means that effective sports medicine and rehabilitation will be a crucial and deciding element in their lives.

Driven by a commitment to facilitate the highest level of active return, the HEALTHSOUTH Sports Medicine Network uniquely integrates a national system of comprehensive and specialized sports medicine resources. Technology, expertise and skill lock together in an effort to bridge the gaps in traditional sports medicine resources, while each Center individually provides specialized care in the highest of clinical standards.

HEALTHSOUTH Sports Medicine specializes in the treatment of competitive and recreational athletes who will benefit from our expertise and resources. Comprehensive programs are individually designed to offer athletes maximal potential for progress through a unique approach — backed by clinical expertise and state-of-the-art technology and equipment.

Our Approach

With patient care as our primary goal, the medical team identifies prospective long and short term goals from patient evaluations and consultations with the physician, trainers and therapists. From this collection of patient data, a specially tailored program is implemented and updated regularly to further support the patient's return to activity.

Our Services

Dynamic and comprehensive programs are designed to return athletes to his or her maximum potential — quickly and safely. Services include:

- Pre-participation Physicals
- Prevention Programs
- On-site Athletic Event Coverage
- Injury Evaluation
- Referral Service
- Strengthening and Conditioning Programs
- Rehabilitation and Treatment Programs
- Education

OUR SPECIALISTS

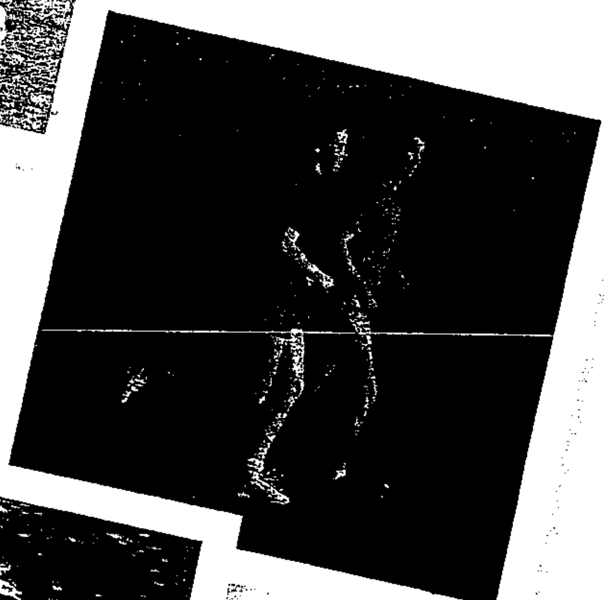
HEALTHSOUTH Sports Medicine Centers each utilize an interdisciplinary team approach, whose professionals have been specially trained in all phases of sports medicine and rehabilitation. Experts specializing in the assessment and treatment of sports injuries include:

- Orthopedists
- Certified Athletic Trainers
- Physical Therapists
- Family Practitioners

OUR RESOURCES

In striving to provide the best patient care in sports medicine, the HEALTHSOUTH Sports Medicine Network has developed an extensive pool of experience and skill from national experts and a myriad of technological resources. Capitalizing on these unique resources, the HEALTHSOUTH Sports Medicine Network is continually collecting, analyzing and tabulating data in order to document results and enable the network to remain on the leading edge in sports medicine and provide the best patient care and education possible.

HEALTHSOUTH is expanding nationwide through a planned system of specialized and comprehensive inpatient and outpatient rehabilitation providers. Through this integrated service system, HEALTHSOUTH is striving to stretch the potential in rehabilitation.



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stock to the VC is that you may be able to sell common stock to employees at prices below the price of the preferred stock, since the various rights and privileges of the preferred enhance its value. This gives the employees the chance for greater equity appreciation than is available to the VC — a recognition of the "sweat equity" of the employees.

Venture capitalists usually have stringent requirements for investing. Generally, they are as follows:

- The business must have a strong management team.
- The business must have definite growth opportunities.
- The business should have some unique characteristic, such as special technology, patents, or key individuals.
- The potential growth of the business must be reasonably predictable within a given time.
- The potential for gain must be greater than the associated risk.

If you feel that your company meets these criteria, you should consider seeking venture-capital financing.

Private Placements

Private placements are the sale of equity securities to qualified investors, often through the use of an agent. These securities are usually sold under Regulation D of the Securities Act of 1933, which provides various exemptions from the registration requirements of the Securities and Exchange Commission (SEC). The exemption most commonly used provides that if you sell only to sophisticated investors (those who have "such knowledge and experience in financial and business matters that [they are] capable of evaluating the merits and risks of the prospective investment"), you may sell an unlimited amount without registration.

Private placements are common in the later growth stages of venture-capital–backed companies. These financings, often over $10 million, are in amounts greater than venture capitalists wish to invest. Sales are effected with the help of investment bankers, who sell directly to institutional investors

would usually not be appealing, even if it appears that the company will be successful.

- The VC will provide significant counsel to the management of the company, usually through a seat on the board of directors. Many venture capitalists were previously successful entrepreneurs and businessmen, and this experience brings added value to the investment. While their role will be that of advisers, VCs will not hesitate to take an active part if it appears that the company is in danger of failing to achieve its objectives. In fact, some arrangements allow the venture capitalists the right to replace the management team.

To compensate for the significant risks of venture-capital investing, the VC seeks an annual rate of return of at least 30 to 40 percent, and many investments perform much better than that — quite substantial, unless you consider that this income must go toward offsetting other investments in growth companies that become worthless.

Although there are many venture-capital firms, most concentrate on a few industries in which they have in-depth knowledge. Many will fund only initial-operations or growth-stage companies; some concentrate specifically on conceptual-stage companies, providing seed capital. *Pratt's Guide to Venture Capital Sources*, published by Venture Economics Inc., 75 Second Avenue, Needham, MA 02192, is an excellent directory of venture-capital companies, which includes information on the size of the fund, the typical size of investment, and the preferred areas for investment. The Western Association of Venture Capitalists, 3000 Sand Hill Road, Building 2, Suite 260, Menlo Park, CA 94025, publishes similar detailed information on its members. In addition, the National Venture Capital Association, 1225 19th Street N.W., Suite 750, Washington, DC 20036, publishes a directory of its members.

VCs will not hesitate to take an active part if it appears that the company is in danger of failing to achieve its objectives.

Venture capitalists most often make their investment in the form of preferred stock, which is convertible at their option into common stock. An advantage of selling preferred

3

rowth	Maturity	Salvage/ Rebuilding
U	U	C
C	S	S
C	U	U
C	C	X
C	X	S
C	C	U

s may result in use of this source

primary source of financing
ind initial-operations stages
a use personal wealth to
seek financing from relatives
ands from private investors,
lerstand the risks involved.
s, or unsophisticated inves-
ns. Such well-intentioned
i try to interfere in the
iether you have one outside
stockholder relations will
if your time. Until you are a
sources to hire a manager of
nd it preferable to deal only
investors who will not un-
ns.

Another source of private capital is your employees. Privately held companies frequently reward employees by giving them the opportunity to buy a part of the business. Or you might issue stock to employees in lieu of raises or bonuses. In any case, there should always be a stock-purchase agreement, which provides a way to repurchase the stock if the employee leaves the company. This agreement should provide a method of valuing the shares, e.g., on the basis of historical financial results or determination by an independent third party.

When considering whether to sell stock to private individuals, keep in mind that unsophisticated investors are more likely to sue you personally if your business loses their money. Even if you have protected yourself with proper disclaimers and legal documentation, fighting such a lawsuit can be an expensive and time-consuming process.

Venture Capital

Venture capital is the name given to organized private financing that can provide substantial amounts of capital through equity purchases to help a growth-oriented company develop and succeed. Venture capital includes many types of organizations — separate companies owned by wealthy individuals; subsidiaries of large financial and industrial corporations; separate public corporations; and, most common, professional partnerships and corporations that raise money from large institutional investors such as pension funds, insurance companies, foundations, and foreign investors. The following characteristics separate venture capital from other forms of equity investment:

- The venture capitalist (VC) has a long-term investment horizon and is willing to wait five to ten years to see a return on the initial investment.
- The VC expects that the company will eventually make a public offering of stock or be acquired by another company. Without this "home run" potential, the investment

W 0877

Imaging/Diagnostic
Practice Valuation Form

Center Name: ______________________________
How many locations do you have? __________
Main Address: ______________________________
____
Contact Person: ______________________________
Main Telephone: ______________________________
Main Fax: ______________________________

PRACTICE OVERVIEW:

1.Form of Ownership

A.. Sole Proprietorship __________ General Partnership ________
Sub Chapter S. Corporation ______ "C" Corporation __________

B. State(s) in which incorporated or registered: ______________________

C. Ownership Breakdown:

Name	Position	%Ownership

2. Office Hours

Monday ____________ Wednesday ____________ Friday ____________
Tuesday ____________ Thursday ____________ Saturday ____________

3. Number of Scans

Indicate the number of scans for the most recent twelve months. Do not include no shows or cancellations (even if there is a charge). Also indicate the number of days worked in each month.

Month	MR	CT	Procedures US	MM	X-Ray	Other	Work Days
TOTAL							

4.Charges and Collections

A. Please indicate the average charge per scan:

$__________MRI w/ contrast - % ___ *
$__________MRI without contrast - ___% *
$__________CT
$__________Nuclear Medicine
$__________Ultrasound
$__________Mammography
$__________X-ray

* % - Percentage of scans that are with contrast or without contrast

B. For the most recent twelve months, please indicate the total amount of charges and collections for each month.

Month	Charges	Collections
TOTAL		

5. Financial Information

Please provide copies of **income statements and balance sheets** for the previous fiscal year end as well as for the current period to date.

6. Accounts Receivable

A. Please provide the following information:
DATE OF REPORT: ____________________
GROSS ACCOUNTS RECEIVABLE: ____________________
CREDIT BALANCES: ____________________
NET ACCOUNTS RECEIVABLE: ____________________

B. If available, using the accounts receivable aging summaries, provide the following information for the most recent three months.

	Month 1	Month 2	Month 3
Date of Aging			
Current Balances	$	$	$
(0-30 Days)	$	$	$
(31-60 Days)	$	$	$
(61-90 Days)	$	$	$
(91-120 Days)	$	$	$
(120 + Days)	$	$	$
Total			

C. Please include a detailed aging report for total accounts receivable.

7. Revenue Mix

Using actual figures for the last month please indicate how the facility's changes are broken down.

	ACTUAL CHARGES
MEDICARE	______________
W/C	______________
COMMERCIAL	______________
MEDICAID	______________
AUTO/PIP	______________
HMO/PPO	______________
BLUE CROSS	______________
ATTORNEY LIAB.	______________
SELF PAY	______________
TOTAL	______________

8. Managed Care Participation

A. Please list all HMO, PPO, and other health plans the center has contractual agreements with.

____
____
____
____

B. Are there any HMO, PPO or other health plan agreements you do not participate in but, would be beneficial to do so. - please list.

____
____
____
____

C. Is your facility Medicare certified? ___________If so, under which program do you participate? Part A or Part B?

9. Practice Assets

A. If available, please provide a list of fixed assets which you own including the purchase date and price of each item, and depreciation schedule.

B. Do you lease any equipment? _____________If yes, please includes list of this equipment and the lease agreements.

Equipment / Vendor / Model / Year Installed / Leased or Purchased / Lease option Buyout

MRI: ____
CT: ____
U/S: ____
MAMMO: ____
NUC MED: ____
X-Ray: ____

C.Do you lease or own your office space/building? Lease____ Own____
If you lease, please provide the following office space information and include a copy of your lease.

Number of square feet ______________________
Rent amount per month______________________
If more than one location please provide above information for each space.

10. Center Staffing

Please complete employee roster detailing title/position, pay rate, average hours per week, and part-time or full-time status. Also, please categorize each employee with one of the following descriptions.

*MRI	*X-Ray
*CT	*Administration
*NM	*Benefits
*US	*Contract Labor
*MM	

Name	Title	Pay Rate	Avg.Hours per Week	P/T or F/T	Category	Total Salary
					Total	

11. *Radiologists Background Information*

Please provide background information on the radiologists in your center, including a copy of their reading agreement.

12. *History of Center*

Please provide a brief overview/history of your center, including years you have been in the area and any previous owners or hospital affiliation.

13. *Management and/or Billing/Collection Agreements*

News from:

HEALTHSOUTH©

For Immediate Release
December 2, 1996

HEALTHSOUTH SIGNS AGREEMENT TO ACQUIRE HEALTH IMAGES, INC.

BIRMINGHAM, Ala and ATLANTA, Ga ... HEALTHSOUTH Corporation (NYSE:HRC) and Health Images, Inc. (NYSE:HII) announced today the signing of definitive agreement under which HEALTHSOUTH will acquire Health Images. Health Images is one of the largest providers of diagnostic imaging services in the United States. Valued at approximately $270 million, the transaction will add 55 imaging centers, including six facilities in the United Kingdom, to HEALTHSOUTH's existing network of over 1,000 locations in 50 states. HEALTHSOUTH is the nation's largest provider of outpatient surgery and rehabilitative healthcare services.

? need partners?

Richard M Scrushy, Chairman of the Board and Chief Executive Officer of HEALTHSOUTH, said "The transaction strengthens our presence in a number of significant markets. Health Images represents a natural fit with HEALTHSOUTH, since 96% of the Health Images facilities overlap with our rehabilitation and surgery locations. Nearly 100% of our patients require some form of diagnostics, and HEALTHSOUTH only represents a small percentage of Health Images' existing referrals. This acquisition demonstrates our commitment to providing high-quality, cost-effective services to insurers, managed care organizations, and self-insured employers. Further, we expect this transaction to be immediately accretive to earnings. Additionally, Health Images has been successful in operating in the United Kingdom, and HEALTHSOUTH will use Health Images' presence as a platform to explore further opportunities."

non M.D.

Robert D. Carl, III. Chairman, President and Chief Executive Officer of Health Images, said "The merger with HEALTHSOUTH Corporation allows Health Images' stockholders to participate in the continued growth of the nation's leading outpatient healthcare services company. In an increasingly competitive healthcare market, the ability to offer multiple services to managed care payors and networks represents increased opportunity. Health Images' reputation and skills as a provider of high-quality radiology services are well established. Combining these with HEALTHSOUTH's extensive expertise and market presence in physical therapy, rehabilitation hospitals and outpatient surgery gives Health Images' stockholders and immediate opportunity which is compelling."

News from:

HEALTHSOUTH®

Under the terms of the agreement, which has been approved by the boards of both companies, Health Images stockholders will receive 0.446 of a share of HEALTHSOUTH Common Stock per Health Images share. There is no provision for either company to terminate the agreement based upon fluctuations in HEALTHSOUTH's stock price. The agreement provides for the payment of a $10 million break-up fee in the event Health Images terminates the transaction under circumstances and is the subject to approval by the stockholders of Health Images and which does not require a vote of HEALTHSOUTH's stockholders, is expected to be accounted for as a pooling of interests and is intended to be a tax-free reorganization. The transaction is subject to various regulatory approvals, including Hart-Scott-Rodino clearance, and to the satisfaction of certain other conditions. The transaction is expected it close in the first quarter of 1997.

Statements contained in this press release which are not historical facts are forward-looking statements. Such a forward-looking statements are necessarily estimates reflecting HEALTHSOUTH's best judgment based upon current information and involve a number if risks and uncertainties, and there can be no assurance that other factors will not affect the accuracy of such forward-looking statements. Certain of such factors are identified in HEALTHSOUTH's periodic reports filed with the Securities and Exchange Commission, and such forward-looking statements should be read in conjunction with such reports.

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For more information contact:

@ HEALTHSOUTH:	*Richard M Scrushy, Chairman & CEO; Aaron Beam, Jr, Executive Vice President & CFO; or Michael D Martin, Executive Vice President & Treasurer at 205-967-7116*
@ Health Images, Inc.	*Robert D Carl, III, Chairman, President & CEO or Laura J Werner, Director of Corporate Affairs at 770-587-5084*

Merrill Lynch

8 October 1996

United States

HEALTHSOUTH Corporation

The Leader of Rehabilitation

INVESTMENT HIGHLIGHTS:

- HEALTHSOUTH is the nation's largest provider of outpatient surgery and medical rehabilitative services, with 96 inpatient hospitals, five medical centers, 134 outpatient surgery centers and more than 700 other locations designed for outpatient rehabilitation and home health care.

- The need for rehabilitation springs from a variety of debilitating conditions, notably strokes, spinal cord injuries, brain injuries and various orthopedic problems. The well known "graying of America" is expected to produce a very favorable patient profile for all health care providers over the next few decades.

- As the leading provider of medical rehabilitative and outpatient surgery services, the company is well positioned to develop relationships with managed care payors. With more than 900 total sites, the company's scope of services and geographic diversification are unmatched in the rehabilitation and outpatient surgery industries.

- Our investment rating on the shares remains B-1-1-9. Our price objective on the shares of $50 assumes the shares can achieve a modest premium to its growth rate on 1997 earnings.

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Merrill Lynch Health Care Services
Margo L. Vignola
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Merrill Lynch & Co.
Global Securities Research & Economics Group
Global Fundamental Equity Research Department

Country: United States. Currency: US$

			EPS (Dec)	P/E	Cash Flow/Sh	P/CF
Price (HRC-NYSE):	$39.5/8					
52-Week Range:	$40-$22	1997E:	$1.81	21.9x	$2.94	13.5x
		1996E:	$1.46	27.1x	$2.48	16.0x
Book Value/Share (6/96):	$7.96	1995A:	$1.08	36.7x	$2.31	17.2x
ROE 1996E Average:	18.4%					
Shares Outstanding (mil.):	154.7					
Market Capital (mil.):	$5,879					
Long Term Liability % of Capital:	51.4%					
Estimated 5 Year EPS Growth:	25%					
Options:	NYSE					
Institutional Ownership-Spectrum:	70%					
Brokers Covering (Nelson):	8					

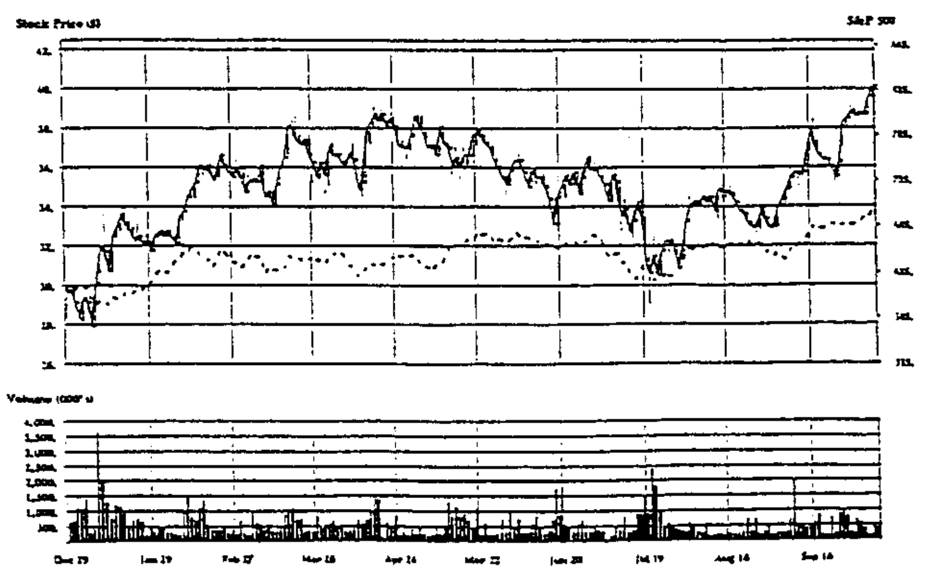
Indicated Dividend Rate	Indicated Dividend Yield
Nil	Nil

Investment Opinion	
Intermediate Term:	Buy (1)
Long Term:	Buy (1)
Income:	No Cash Dividend (9)
Investment Risk:	Average (8)

Investment Overview and Summary

HEALTHSOUTH is the nation's largest provider of outpatient surgery and medical rehabilitative services, with 96 inpatient hospitals (and nearly 6,000 beds), five medical centers (912 beds), 134 outpatient surgery centers and more than 700 other locations designed for outpatient rehabilitation and home health care. Total revenues in 1995 were $2.0 billion compared with $979 million in 1993. During the past decade, the company has become one of the largest providers of health care services in the nation. Its strong growth has primarily been the result of favorable demographics and cost containment pressures by third party payors which has led to quicker hospital discharges. Also, advancements in medicine have increased life expectancies and the survival rates for various injuries and diseases. More recently, HRC has utilized an aggressive acquisition strategy to significantly boost revenues and broaden its geographic reach. Lastly, as the lowest cost provider of these services, the company has been able to garner stronger ties with managed care companies. Indeed, the company has more than 1,600 managed care contracts.

HEALTHSOUTH Corporation
Daily Stock Price and Trading Volume from 12/29/96 to 10/7/96



The company was formed in early 1984 by five former executives of Lifemark Corporation, a health care services company that was acquired by American Medical International in the early 1980s. HEALTHSOUTH'S founder and current Chairman and CEO, Richard Scrushy, had worked at Lifemark Corp. since the late 1970s. The company opened its first outpatient rehabilitation center in September 1984, and since this time it has combined an opportunistic acquisition strategy with a focused internal growth strategy to become the nation's largest provider of outpatient surgery and rehabilitative services.

The growth of the rehabilitation industry (both in the inpatient and outpatient setting) has been dramatic over the past decade. The implementation of DRGs in the early 1980s created the need for alternate site care, as traditional community hospitals were incented to shorten lengths-of-stay and accelerate discharges. However, an increasing number of these patients were not healthy enough to safely return home, and this fostered a greater need for more cost-effective, alternative institutional care. During the 1990s, however, the continued strong growth of managed care has led to a "rebundling" of health care services. HEALTHSOUTH, we believe, will be one of the primary beneficiaries of this rebundling of services, as it can increasingly provide to managed care payors a broader spectrum of health services over a wide geographic area.

HEALTHSOUTH Corporation
Recent Acquisition History

Company Acquired	Year	Facilities	Type	Consideration
NME Reab Hospitals	1993	28	Cash	$365
ReLife	1994	13	Pooling	$220
NovaCare Rehab. Hospitals	1995	11	Cash	$245
Surgical Health Corp.	1995	42	Pooling	$240
Sutter Surgery Centers	1995	12	Pooling	$50
Caremark Orthopedics	1995	120	Cash	$125
Surgical Care Affiliates	1996	67	Pooling	$1,400
Advantage Health Corp.	1996	150	Pooling	$345
Professional Sports Care	1996	36	Pooling	$70
		479		$3,060

Source: HEALTHSOUTH Corporation

Company Description

HEALTHSOUTH Corporation, based in Birmingham, Alabama, was founded in 1984. Through a series of strategic acquisitions and impressive same-store results, the company has become the leading player in the rehabilitation and outpatient surgery industries. Since 1993, the company has completed transactions totaling more than $3 billion, most notably acquiring the rehabilitation operations of National Medical Enterprises in 1993 for $365 million in cash and Surgical Care Affiliates (the leading outpatient surgery company for $1.4 billion in stock). The company also acquired the rehabilitation hospitals of ReLife, Inc (for $220 million) and NovaCare ($245 million) as well as a host of other outpatient rehabilitation centers. Today, the company is the clear leader in both the inpatient/outpatient rehabilitation and outpatient surgery markets, operating more than 900 facilities in 45 states with projected revenues in 1996 of $2.48 billion.

Key Positives

- **Rapid Growth in the Core Businesses:** The rehabilitation market is estimated to generate more than $25 billion in annualized revenues. The need for rehabilitation springs from a variety of debilitating conditions, notably strokes, spinal cord injuries, brain injuries and various orthopedic problems. The well known "graying of America" is expected to produce a very favorable patient profile for all health care providers over the next few decades. Also, advances in medical technology and a greater awareness of and appreciation for rehabilitation therapy as a cost effective service are also expected to boost demand.

- **The Outpatient Surgery Market:** Advances in medical technology have fueled the growth of outpatient surgeries, a trend likely to continue. Approximately 60% of all surgeries were performed on an outpatient basis in 1995, and this percentage has steadily increased over the past few years. The company's acquisitions in this industry over the past year have made HEALTHSOUTH the leading provider of outpatient surgery services in the nation.

- **Well Positioned for Managed Care:** As the leading provider of medical outpatient surgery and rehabilitative services, the company is well positioned to develop relationships with managed care payors. With more than 1,000 total sites, the company's scope of services and geographic diversification are unmatched in the rehabilitation and outpatient surgery industries. We expect the company to increasingly develop its managed care business, which will boost the top line as well as margins. Currently, less than 5% of revenues are derived from capitated agreements with managed care companies. However, given the company's ability to bundle a number of services (i.e. diagnostics, outpatient surgery, and outpatient/inpatient rehabilitation), we expect this percentage to steadily rise over the next few years.

Risks

- **Government regulation.** The health care industry is closely regulated by state and local governments. It is difficult to predict with certainty the future policies of government concerning Medicare/Medicaid reform and rates of reimbursement. However, HEALTHSOUTH currently derives less than 40% of revenues from these government programs (less than 2% from Medicaid).

- **Acquisitions.** While HEALTHSOUTH has an excellent track record of rapidly integrating acquisitions, a growth strategy which incorporates acquisitions is always accompanied by a certain level of risk.

Core Operations

As the nation's leading provider of rehabilitative and outpatient surgery services, HEALTHSOUTH operates more than 1,000 facilities in 48 states. As illustrated below, the company has completed a number of strategically important acquisitions over the past three years, and these have provided the company with the necessary scope of services and geographic diversification necessary to effectively work with managed care payors. The company's largest acquisition, in terms of price, occurred in early 1996 when the company completed its $1.4 billion acquisition of Surgical Care Affiliates, a leading outpatient surgery centers.

Inpatient Rehabilitation: HEALTHSOUTH currently operates 96 inpatient rehabilitation hospitals (with nearly 6,000 beds) in 28 states. (We would point out that there are only 187 inpatient rehabilitation hospitals in the country, giving the company a market share of just over 51%). Generally speaking, patients who require inpatient physical rehabilitation have experienced a significant injury or

suffered a major illness. Examples include head injury, spinal cord injuries, strokes, certain orthopedic problems and neuromuscular diseases. In order to develop its relationships with HMOs, HEALTHSOUTH has developed a number of clinical patient programs and report cards in its rehabilitation hospitals, designed to produce reports on outcomes and quality assurance. Internal case managers track each patient's progress and medical status and are able to provide documentation of a patient's medical progress. Also, some of HRC's inpatient rehabilitation hospitals have initiated programs with several prominent medical research universities. For example, HRC has established a Neuroscience Center with the University of Miami, as well as a Research Center in connection with Vanderbilt University.

HEALTHSOUTH Corporation
January 31, 1996

LOCATION	Outpatient Rehabilitation Centers	Inpatient Rehabilitation Facilities Licensed Beds	Medical Centers Licensed Beds	Surgery Centers	Diagnostic Centers	Other Services
AL	19	1,514	219	5	4	3
AL				1		
AR	17	183		2		
AK	2	60		2		
CA	46	60		18		1
CO	21			4		3
CT	1					
DE	4					
D.C	1				1	
FL	47	558	794	20	2	2
GA	8	164		4	1	
HI	3			1		
IO				1		
IL	46			2		
IN	13	60		2		
IO	3					
KS	1					
KY	2	40		2		
LA	2	43		1		1
ME	2					
MD	15	44		5	3	
MA	1			1		
MI	1			1		
MS	3					
MO	30	68		6		3
NE	2					
NV	1					
NH	7	100				
NJ	18	170		2		3
NM	3	60		1		
NY	12					
NC	13	17		3		
OH	24			1		
OK	9	111	3	1		
PA	21	1,147	5			1
SC	8	321	2			
TN	13	330		6	1	
TX	42	1,392	96	14	3	9
UT	1	86	1			
VA	10	252	200	1	1	1
WA	23			1		
WV	1	200				
WI	1			4		
TOTAL	489	7,220	1,320	112	16	27

Outpatient Rehabilitation: In addition to being a leader of inpatient rehabilitative services, HEALTHSOUTH is also the leading provider of outpatient rehabilitative services, with approximately 700 locations in 39 states. The company's outpatient centers are designed to treat a number of different patients, including those

suffering from less acute problems associated with strokes, orthopedic and head injuries and neuromuscular diseases. Generally speaking, many of the patients require a treatment program which consists of about 10 visits (three per week for one hour each visit). Due to quicker discharges from inpatient hospitals (nearly 90% of nationwide admissions to such facilities are derived from hospital discharges). The average acuity level at these outpatient centers has steadily risen over time.

Medical Centers: In addition to its rehabilitation facilities, the company also operates five (JCAHO accredited) acute care hospitals (912 beds) in four states. HEALTHSOUTH's medical centers are located in large urban areas, and mostly coincide where the company has a significant rehabilitation presence. The company purchased its first medical center in 1989, when it acquired South Highlands Hospital Association in Birmingham, Alabama for about $20 million in cash and $30 million in assumed debt. Although the company has expanded its acute care operations through acquisitions in Virginia, Florida and Texas, we do not believe that it will make any meaningful entry into this market.

Surgery Centers: Through a series of recent acquisitions, HEALTHSOUTH has become the leading provider of outpatient surgery services in the nation. As of March 31, the company operated 128 free-standing surgery centers (including five mobile lithotrispy units) in 30 states and has about 10 free standing surgery centers under development. The strategy behind the company's entry into this market is simply to secure a strong base of referrals for its inpatient and (primarily) its outpatient centers. Also, with the continued development of managed care, the company can increasingly contract with these payors, offering a more complete package of non-acute services than most of its competitors.

Financial Results and Projections

- HEALTHSOUTH reported second quarter results ahead of expectations, with earnings per share (fully diluted) up by 44% to $0.36 compared with $0.25 last year, beating our estimate by $0.01. Revenue growth continued strong in the quarter, rising by 19.2%, to $596 million vs. $499.7 million last year.
- More impressive in the quarter, HRC continues to experience impressive margin improvements. As a percentage of revenues, operating costs fell by more than 400 basis points (and on a sequential basis, these costs fell by 120 basis points). Some of this gain was offset by a rising corporate and administrative ratio, which increased as a percentage of revenues from 2.6% last year to 2.8% (although this ratio was flat on a sequential basis). The company's EBITDA (earnings before interest, taxes, depreciation and amortization) margin increased by 370 basis points from last year (from 26% to 29.7%) and on a sequential basis, this margin increased by 110 basis points.

Details

Second Quarter Results Continue to Impress: HEALTHSOUTH reported second quarter results ahead of expectations, with earnings per share (fully diluted) up by 44% to $0.36 compared with $0.25 last year, beating our estimate (and the street consensus) by $0.01. For the six months, earnings per share increased from $0.48 last year to $0.70 this year, a gain of 45.8%. Revenue growth for HRC continues to be quite strong, with total sales up by 19.2%, to $596 million compared with $499.7 last year. For the six months, revenues increased from $951.5 million to $1.2 billion, a gain of 23.7%.

Utilization Remains Strong

Driving the company's top line was strong utilization results across the board, with outpatient visits up by 63%, inpatient rehabilitation days up by 14% and surgery center cases up by 10%. Results at HRC continue to benefit from the company's

aggressive acquisition strategy. As illustrated below, the company has completed two major acquisitions this year (Surgical Care Affiliates and Advantage Health Corp) and is in the process of completing its acquisition of Professional Sports Care Management, an operator of 36 outpatient rehabilitation locations. That deal is expected to close before the end of the third quarter. In addition, the company has also acquired (in the second quarter) over 25 outpatient rehabilitation facilities.

Same Store Growth Ramps Up

On a same store basis, HRC continues to experience impressive results. Its Outpatient Rehabilitation division experienced same-store revenue growth of 15.5%. The company's Inpatient Rehabilitation division experienced same-store growth of nearly 11%, impressive given the continued flat pricing that division has experienced over the past few years. Lastly, the company's Surgery Center Division experienced stronger than expected same-store growth of 6.3% (compared with 5.9% in the first quarter). Importantly, results at Surgical Care Affiliates (a large acquisition completed in early 1996) improved dramatically in the quarter (that company's internal growth rate was only about 3% at the time of the acquisition). Moreover, HRC's efforts to improve Surgical Care's growth, in our view, are just beginning to be realized, and we look for more improvements throughout 1996. In addition to improving same-store growth for this division, HRC has been able to improve revenues-per-case, which increased from $1,200 at the end of last year to approximately $1,300 during the second quarter.

Margins Improvement Accelerates

Although revenue growth was strong, more impressive in our view was HRC's margin improvements. As a percentage of revenues, operating costs fell by more than 400 basis points from 69.4% last year to 65.3% this year; on a sequential basis, these costs fell by 120 basis points. We had expected some gains in this cost ratio, due to improved operating efficiencies and some changes in the company's sales mix, but these gains easily surpassed our expectations. However, some of this improvement in lower operating units was offset by a rising corporate and administrative ratio, which increased as a percentage of revenues from 2.6% last year to 2.8% this year (although this ratio was flat on a sequential basis). The company's EBITDA (earnings before interest, taxes, depreciation and amortization) margin increased by 370 basis points from last year (from 26% to 29.7%) and on a sequential basis, this margin increased by 110 basis points.

Outlook

We believe that HRC remains one of our better investment ideas in healthcare. As the company's second quarter results indicate, top line growth and improving margins continue to drive earnings higher. Moreover, given the company's strong network development, we believe that it will increasingly develop its managed care business. The company currently has more than 1,600 contracts with managed care companies and we look for this business to continue to expand.

Projections

As illustrated on the page 8, we look for HEALTHSOUTH to increase revenues by about 22% this year, due both to a number of acquisitions as well as same store growth in the low double digit range. Revenues are expected to reach about $2.4 billion this year, up from $2.0 billion in 1995. In 1997, we expect revenues to increase to $2.83 billion. To complement its strong top line, we expect margins gains to continue, due to a better sales mix, greater managed care business as well as operating efficiencies. The company's EBITDA (earnings before interest, taxes, depreciation and amortization) margin is expected to increase by about 240 basis points to 29.2% vs. 26.8% in 1995. In total, we look for earnings to rise by about 35% this year, to $1.46 from $1.08 last year. In 1997, we look for a gain to $1.81.

HEALTHSOUTH Corporation
Consolidated Statements of Income
(In Millions, Except Per Share)

	Historical Results 1995 Mar-95	Jun-95	Sep-95	Dec-95	Total	1996 Mar-96	Jun-96	Projections Sep-96	Dec-96	Total	1997 Mar-97	Jun-97	Sep-97	Dec-97	Total
Net Revenues	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Operating units	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Corporate general & administrative	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Provision for doubtful accounts	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Total Operating Expenses	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Other expenses															
Depreciation & amortization	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Interest expense	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Interest income	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Merger expenses and other one time charges	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Pretax income	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Tax expense	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Income before minority interest	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Minority interest	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Net income	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
EBITDA	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
EBITDA margin	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Earnings per share (fully diluted)	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Common share outstanding (fully diluted)	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Effective tax rate	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Margin Analysis															
Net Revenues	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Operating units	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Corporate general & administrative	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Provision for doubtful accounts	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Total Operating Expenses	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Other expenses															
Depreciation & amortization	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Interest expense (income)	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Merger expenses	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Pretax income	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Tax expense	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Income before minority interest	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Minority interest	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Net income	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Growth Analysis															
Net Revenues						[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Operating units						[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Corporate general & administrative						[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Provision for doubtful accounts						[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Total Operating Expenses						[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Other expenses															
Depreciation & amortization						[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Interest expense (income)						[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Pretax income						[illegible]	NMF	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Tax expense						[illegible]	NMF	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Income before minority interest						[illegible]	NMF	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Minority interest						[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Net income						[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
EBITDA						[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
E.P.S. (fully diluted)						[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]

Note: Adjusted amounts exclude one time merger charges and have been restated to reflect poolings of interests.
Source: HEALTHSOUTH Corp & Merrill Lynch.

Percentage of Persons by Age Group that have a Functional Limitations

Age	Total (1,000s)	% With a Functional Limitation	% With a Severe Functional Limitation
15-24 years	39,297	5.2%	0.9%
25-34 years	40,464	7.5%	1.5%
35-44 years	30,480	13.4%	2.9%
45-54 years	22,264	23.0%	6.4%
55-64 years	22,060	34.2%	12.4%
65 years & over	26,422	58.5%	28.5%
65-69 years	8,928	45.4%	18.8%
70-74 years	7,378	55.3%	22.9%
75 years & over	10,116	72.5%	41.2%

Source: American Rehabilitation Association, 1994

Often, the first phase of rehabilitation is provided in an acute care hospital. Once stabilized, patients are often transferred to a rehabilitation facility which provides a wide range of services and therapies. The care is focused on the recovery of a patient's physical and cognitive abilities. Outpatient rehabilitation is often provided after an inpatient stay. Some units are part of an inpatient facility or operate on a freestanding basis.

The number of rehabilitation facilities has grown steadily, in tandem with demand. Between 1985 and 1989 alone, the number of rehabilitation hospitals rose by 83.8% (21.0% per year). The number of rehabilitation units increased by 66.3% over the same period, 16.6% a year. The pace has slowed down in the 1990s, with capacity up by 44.0%, a compound rate of 11.0%. The industry's growth stands in contrast to the steady decline in the number of acute care hospitals

Yearly Estimates of the Number of Rehabilitation Facilities, SNFs, and Long-Term Care Hospitals in the U.S. 1985-1994.

Type of Facility	1985	1987	1989	1991	1993	1994
Rehabilitation Hospital*	68	88	125	152	180	187
Rehabilitation Units+	386	539	642	672	783	804
Long-Term Care Hospitals‡	86	87	89	91	109	113
Skilled Nursing Facilities (SNFs)	6725	7,379	8,688	10,061	11,309	11,436
Comprehensive Outpatient** Rehabilitation Facilities++	86	141	184	201	229	237

* Number of Hospital excluded from coverage under the Medicare Prospective Payment System (PPS)
\+ Number of Units excluded from coverage under the Medicare PPS
‡ Number of long-term care hospitals excluded from coverage under the Medicare PPS
** Number of SNFs participating in Medicare Health Insurance Program
++ Number of CORFs participating in Medicare Health Insurance Program

Source: HCFA

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The Rehabilitation Industry

Medical rehabilitation is another facet of long term care, one that seeks to minimize the physical, intellectual and social consequences of disease, illness, injury and congenital conditions. At the same time, rehabilitation seeks to maximize functional ability, restore or enhance vocational skills and prevent the need for institutionalization. Services are designed to help the physically injured or impaired to regain maximum function, mobility and independent living.

The need for rehabilitation springs from a variety of debilitating conditions, notably strokes, spinal cord injuries, brain injuries, orthopedic problems, arthritis, amputations, cancer, respiratory dysfunction and a number of neurologic conditions. In addition, traumatic injuries from auto accidents and other traumatic events have also led to greater demand for these services. The incidence of these conditions has steadily increased over time, in part due to the aging of the population. Lastly, medical limitations rise steadily with age. For example, nearly 600,000 individuals (primarily over the age of 65) in the U.S. suffered a stroke last year.

Conditions With the Highest Prevalence of Activity Limitation

Condition	Prevalence(1,000's)	Percentage
Orthopedic Impairments	6,987	13.3%
Arthritis	6,130	11.6%
Heart Disease	5,575	10.6%
Hypertension	3,506	6.6%
Visual Impairments	2,900	5.6%
Diabetes	2,111	4.0%
Mental Disorders	1,837	3.5%
Asthma	1,783	3.4%
Invertebral Disk Disorders	1,699	3.2%
Nervous Disorders	1,601	3.0%
Hearing Impairment	1,405	2.6%
Mental Retardation	1,047	2.0%
Emphysema	994	1.9%
Cerebrovascular Disease	939	1.8%
Abdominal Hernia	595	1.1%

Source: American Rehabilitation Association, 1994

Projected Growth of Number of Persons 65 Years and Older in the U.S. 1995-2075

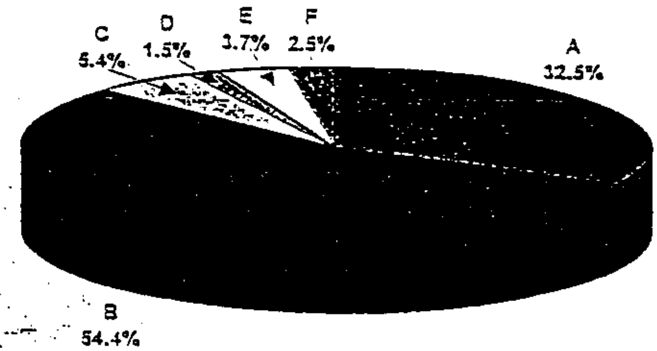
Aged Population Projection (millions)	1995	2000	2025	2050	2075
65 Years and older	34.0	35.2	60.6	73.7	83.3
75 Years and older	15.0	16.7	25.0	38.9	45.7
85 Years and older	3.8	4.4	6.3	14.6	16.9

Source: HCFA

In addition, those suffering severe traumatic injuries are more often likely to survive and need rehabilitation. The survival rate for those suffering severe traumatic injuries has increased dramatically, rising from 50% in the mid-1980s to 90% today. Of two million head trauma victims, 25% require extensive rehabilitation. In addition, an estimated 9% (14.2 million) of working age people in the United States have some work disability.

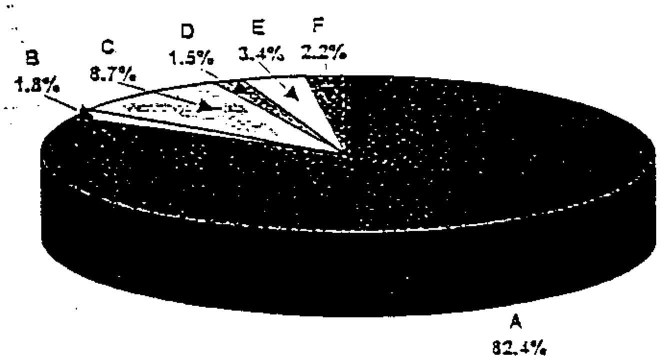
At this juncture, 187 rehab facilities are in operation, in addition to 804 rehab units. There are 237 comprehensive outpatient rehabilitation facilities (certified by Medicare since 1980). In addition, 48.2% of acute care hospitals maintain an outpatient program. Between 1980 and 1992, Medicare outpatient physical therapy providers grew at an average annual pace of 21.8% to 1,481 providers. By 1992, an estimated 2,600 outpatient units were in operation. All told, some estimates imply that between 7,000 and 10,000 outpatient and inpatient rehabilitation units exist today in the U.S.

Percentage of Rehabilitation Unit Admissions by Referral Source



A: Transfer from other hosp.
B: Transfer from same hosp.
C: Home/Self referral
D: Nursing Home/ECF
E: Other
F: Outpatient clinics
Admissions: 76,193

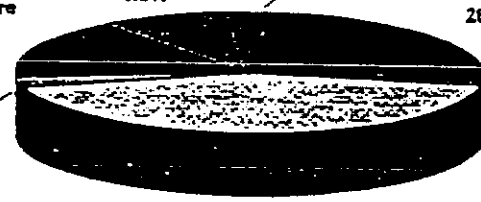
Percent of Rehabilitation Hospital Admissions by Referral Source



A: Transfer from other hosp.
B: Transfer from same hosp.
C: Home/Self referral
D: Nursing Home/ECF
E: Other
F: Outpatient clinics
Admissions: 45,137

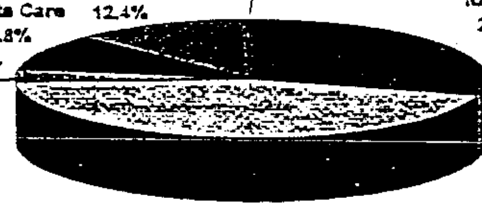
Annual revenues have grown at a compound annual pace of 20% per year over the past 12 years. The primary drivers have been increased demand and increased capacity. The industry generated about $23 billion in revenues in 1994. Of this amount, 66% was generated by Medicare, 5% from private sources and the balance from commercial health insurance. The lion's share (87%) of referrals is provided by discharge from inpatient facilities. Some 82% are discharged back to the community.

Percent of Rehabilitation Hospitals by Discharge Site



Source: AHA Survey, 1991

Percentage of Rehabilitation Unit Patients by Discharge Type



Source: AHA Survey, 1991

Medicare has steadily become the leading source of funds, accounting for 71% of total days in rehabilitation facilities.

Medicare Days as a Percent of Total Utilization Days

Year	Hospitals % of days that are Medicare days	Units % of days that are Medicare days
1986	57.3%	58.1%
1987	57.3%	58.1%
1988	59.2%	59.6%
1989	60.5%	63.5%
1990	64.5%	66.6%
1991	64.0%	68.2%
1992	66.1%	70.7%
1993E	67.7%	73.0%
1994E	59.3%	75.4%
1995E	70.9%	77.9%

Source: HCFA and Merrill Lynch Research Estimates

Average occupancy rates tend to be relatively high at 73.3% in freestanding hospitals and somewhat higher than the 66.1% in hospital based rehab units.

Occupancy Rates in Rehab Hospitals and Units

Year	Hospitals Average occupancy Rate	Units Average Occupancy Rate
1986	76.6%	72.1%
1987	68.1%	71.8%
1988	69.5%	71.8%
1989	69.0%	72.2%
1990	72.0%	71.1%
1991	75.6%	71.7%
1992	73.3%	70.3%

Source: HCFA

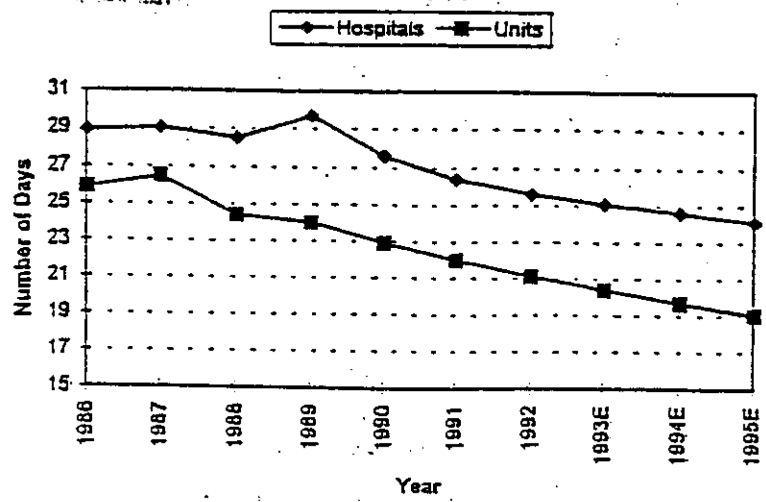
The average length of stay, moreover, has steadily declined, falling by three to four days over the past decade. The average length of stay is about 20 days in rehabilitation hospitals and 24 days in acute care hospital units. In part, the decline reflects cost containment pressures. However, improved technology and the growing availability of outpatient services has also contributed.

Average Length of Stay (LOS) (in days) of Rehabilitation Patients in Hospitals and Units: 1986-1995

Year	Hospitals Average LOS	Units Average LOS
1986	28.9	25.9
1987	29.0	26.5
1988	28.5	24.4
1989	29.7	24.0
1990	27.6	22.9
1991	26.4	22.0
1992	25.6	21.1
1993E	25.1	20.4
1994E	24.6	19.7
1995E	24.1	19.0

Source: HCFA, Merrill Lynch Research Estimates

Average Length of Stay for Rehabilitation Patients



Source: HCFA; Merrill Lynch Research Estimates

Average Length of Stay (LOS) (in days) of Rehab Patients By Condition

Condition	1990	1991	1992
Stroke	32	29	28
Orthopedic Conditions	21	19	18
Brain Dysfunction-Nontraumatic	34	35	32
Brain Dysfunction-Traumatic	46	41	40
Spinal Cord Dysfunction-Nontraumatic	33	30	27
Spinal Cord Dysfunction-Traumatic	51	55	45
Neurologic Conditions	28	26	25
All Patients	28	26	24

Source: American Journal of Physical Medicine & Rehabilitation

Average charges vary by condition. The average charge per day was an estimated $58 per day higher with Medicare than with traditional commercial pay. Indeed, the increase in Medicare costs was 78% over the 1986-1994 period, compared to an estimated 58% for non-Medicare patients.

Average Rehabilitation Charge by Condition in 1990-1991

Condition	Average Charge
Spinal Cord Dysfunction-Traumatic	$46,409
Brain Dysfunction-Traumatic	$36,161
Major Multiple Trauma	$29,336
Pulmonary	$29,091
Brain-Dysfunction-Nontraumatic	$29,047
Spinal Cord Dysfunction-Nontraumatic	$25,404
Stroke	$24,672
Neurologic Conditions	$22,813
Lower Extremity Amputation	$22,005
Other	$21,849
Amputation-Other	$18,717
Arthritis-Rheum & Other	$18,261
Ortho-Other	$17,055
Lower Extremity Fracture	$16,617
Cardiac	$16,411
Pain	$16,097
Arthritis-Osteo	$16,029
Joint Replacement	$15,104
All Patients	$13,328

Source: American Rehab Association (1994).

Average Operating Cost per Hospital Inpatient Rehabilitation Day: 1986-1995

Year	All Patients Average Operating Cost Per Day	Medicare Patients Average Operating Cost Per Day	Non-Medicare Patients Average Operating Cost Per Day
1986	$340	$330	$359
1987	$360	$369	$364
1988	$399	$415	$384
1989	$418	$441	$418
1990	$455	$480	$439
1991	$520	$537	$493
1992	$561	$567	$547
1993E	$611	$620	$587
1994E	$666	$678	$630
1995E	$726	$742	$689
1996E	$791	$812	$754

Source: HCFA, Merrill Lynch Research Estimates

Average costs have risen at a similar pace, holding gross margins about the same.

Average Operating Cost per Inpatient Rehabilitation Hospital Discharge 1986-1995

Year	All Patients: Average Operating Cost Per Discharge	Medicare Patients Average Operating Cost Per Discharge	Non-Medicare Patients Average Operating Cost Per Discharge
1986	$10,343	$8,383	$13,644
1987	$11,025	$8,813	$13,784
1988	$11,870	$10,175	$14,613
1989	$13,298	$10,877	$13,360
1990	$13,245	$12,743	$14,486
1991	$14,406	$12,890	$16,691
1992	$14,973	$13,010	$19,494
1993E	$15,924	$13,999	$20,683
1994E	$16,937	$15,063	$21,945
1995E	$18,014	$16,208	$23,284
1996E	$19,165	$17,440	$24,704

Source: HCFA; Merrill Lynch Research Estimates

Chain ownership of rehabilitation units is quite limited. One company, HEALTHSOUTH, controls 5,682 beds and 90 facilities. The next largest concern, Horizon/CMS, controls 37 facilities and 2,525 beds. While other chains may include rehabilitation units, the relative numbers are quite small.

Leading Operators of Rehabilitation Hospitals

	Beds		Hospitals		# of States
	1995	1994	1995	1994	
HealthSouth Corp.	4,678	4,006	78	67	43
Horizon/CMS	2,515	2,544	37	36	14
Tenet Healthcare Corp.	555	555	6	6	NA
Advantage Health Corp.	388	388	3	3	7
Sun Healthcare Group	174	130	4	4	NA
Other	3,248	2,981	40	36	

Source: Modern Healthcare, 1996